



**Prepared Statement of
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On behalf of the
Small Business & Entrepreneurship Council**

On

**Paperwork Reduction Efforts of the
Internal Revenue Service**

Before the

**Subcommittee on Regulatory Affairs
Committee on Government Reform
U.S. House of Representatives
Candice S. Miller, Chairman**

May 25, 2005

Chairman Miller and members of the House Subcommittee on Regulatory Affairs, thank you for the invitation to participate in today's hearing to examine the impact the tax system paperwork burden has on the small business community and whether the Internal Revenue Service's processes for implementing policies and standards that reduce the government paperwork burden, as mandated by the Paperwork Reduction Act of 1980 (and as amended), are beneficial to small businesses.

My name is Leonard Steinberg. I am an Enrolled Agent and a Certified Management Consultant. I am the president of The Steinberg Group, a West Windsor, New Jersey consulting practice that concentrates in the areas of accounting, financial and administrative operations, taxpayer representation before the Internal Revenue Service, and Board of Directors development for nonprofits and small businesses. I am a member of the Small Business & Entrepreneurship Council (SBE Council), who I represent today, a national, nonpartisan organization whose advocacy efforts work to protect small business and promote entrepreneurship.

I was a member of the Taxpayer Advocacy Panel (TAP) and chair of the committee on Small Business/Self Employed Payroll tax from 2002 through 2004. Prior to this position, I was a member of TAP's predecessor, CAP, for one year, from New York. Our TAP committee was charged with researching and recommending policies and procedures for reducing taxpayer, (i.e. small businesses), burden with respect to accurate and timely filing, reporting and payment of payroll taxes. During this period of time, our committee reviewed the current IRS documentation and made specific recommendations to reduce burden on small businesses.

This testimony is based on our TAP committee's findings and observations and on my professional consulting and tax practices.

Burden:

Taxpayer burden begins at enactment. In my previous testimony to the Small Business Committee, chaired by Congressman Donald A. Manzullo, I discussed the implications of tax

law complexity and its associated burden on small businesses. This burden is directly related to the forms and publications printed by the IRS.

As an example, on the revised W-4 form (Employee's Withholding Certificate) for 2005, the information regarding the Paperwork Reduction Act is printed in very small print on Page 2 of the form. The form states, "The time needed to complete this form will vary depending on individual circumstances. The estimated average time is: Recordkeeping 45 min.; Learning about the law or the form, 12 min.; Preparing the form, 58 min." For 2004, the estimated times for Recordkeeping, Learning about the law or form and Preparing the form, were only 1 minute longer than for 2005.

The total time for this form is 115 minutes, almost 2 hours. This form is a prime example of how burden is not reduced. From experience, I know that learning about the tax laws associated with this form take much longer than the estimated 12 minutes.

In addition, there are many employees who require multiple W-4 forms due to changes in their personal circumstances or more often for working at second jobs.

The government does not employ a measurement tool to determine the cost to the small business employer in lost productivity. This lost productivity can only be made up through additional hours spent by the employer or passing on the costs to the consumer. This additional time affects the employer's quality of life and associated family issues, as well.

The Paperwork Reduction Act language on the forms states an average amount of the time required to correctly complete the form(s). These times are arbitrary and based on the ability of the preparer. Once again, many small businesses must rely on and pay for professional assistance in order to comply with the tax laws. Many small businesses do not have adequate budgets and funds to pay for professional help. This only increases the burden and the probability that errors of omission and commission will occur.

When errors occur, the IRS must spend the resources to notify the small business that a correction is necessary. These additional communications add significant burdens to small business owners since the letters sent by the IRS are difficult to understand. Once again, the small business owner is required to pay for professional assistance in order to comply with the notice(s).

The TAP Committee on Notices worked with the Notice Process Initiative Team to recommend changes. Currently the multiple notices cause confusion to the recipients. The revised notices would provide enough detail and explanation for the small business to prepare for follow-up action. The IRS could realize cost savings and staffing demands by reducing the need to maintain obsolete programming and procedural guidelines.

As tax law and its enactment remains complex, the small business owner is forced to rely on professionals to assist with the timely filing, reporting and payment of all prescribed taxes. These additional costs are either passed on to the consumer or deducted from the small business owner's ability to pay himself/herself an adequate wage or give well-earned raises to the employees.

In this case, the Paperwork Reduction Act does not reduce burden on small business employers. Compliance only increases the amount of time small business employers must expend. According to the Small Business Administration's analysis, small firms with fewer than 20 employees spend 60 percent more per employee than larger firms to comply with federal regulations. Small firms spend twice as much in dollars on tax compliance as their larger counterparts.

The IBM Company prepared a report to the Internal Revenue Service, dated February 17, 2004. The report was the Final Report on Qualitative Research for the Small Business Taxpayer Burden Study. The report is replete with examples of burden on the small business taxpayer.

Measuring Burden:

Currently, the Congressional Joint Committee on Taxation scores tax law changes only for dollars and not for complexity or burden. The IRS does not know how to measure burden. There are no statistical models used by either the Joint Committee or the IRS to determine the extent of the burden imposed on small business.

The Joint Committee and the IRS can only measure the effect of any tax law. The Joint Committee and the IRS rely on professional organizations outside of government to provide additional data on the implied costs to small business. This is accomplished through hearings such as this and position papers on proposed legislation.

In the IRS Strategic Plan for 2005 – 2009, the heading on Page 17 of the document states, “How We Will Measure Success In Improving Taxpayer Service.” One of the measures mentioned is burden reduction. The document states that success through burden reduction will entail, “measurements of time and out-of-pocket expense taxpayers incur in meeting their tax responsibilities.” The document does not state nor explain the methodology the IRS will implement to complete this task nor what the IRS will do with their findings.

Unless there is a concerted effort to effectively and correctly, statistically and financially, measure the costs associated with burden, the small business community will continue to bear the disproportionate share of burden in order to comply.

States’ Burden:

Our TAP committee was directed to analyze and propose a methodology by which the IRS could capture tax payments and Federal Unemployment Insurance and remit the payments and related information to the respective state processing centers. After extensive effort, our committee concluded that there was no practical method to accomplish the IRS request. Our committee found out that the IRS does not have the best reputation among the states. Therefore, each state

requires its own statutory process for filing, reporting and payment of income tax and/or Federal Unemployment tax.

The states taxing authorities have their own processes and methodologies and do not follow federal regulations. Therefore, this increases the burden on small businesses. Each small business is required to file separate returns. This increases the amount of paperwork required. It also increases the amount of time the small business owner must spend on paperwork allocated to federal and state tax law compliance. As with the issue of tax complexity, these additional burdens decrease productivity and negatively impact the daily business process.

If the objective is to reduce paperwork, this objective has failed. The small business community still spends a disproportionate share of resources (time, personnel and dollars) in order to comply with the regulatory process.

Additional Examples:

Our TAP Committee analyzed the issue of Payroll Deposit Penalties. Our findings were that the information and instructions were confusing and hard to follow and there were too many levels of deposit penalties. Our recommendations to our Issue Owner included a restructuring of the entire Payroll Deposit Penalty process and a reducing the number penalties and categories.

The IRS instituted a matching process for the revised K-1 form. This form is used by small businesses (S-Corps), partnerships, and estates and trusts to convey financial and tax information related to the individuals return. The complexity and completion of these forms increases burden due to the complexity and changes in tax law.

Schedule D is used to delineate financial instrument transactions (e.g. stocks, bonds, etc.). The IRS does not currently accept a roll up log for active traders (e.g. day traders). However, roll up activity is acceptable for charitable donations. The IRS states that the reason the Service requires complete Schedules D is that the information is used for research purposes. Once again, the preponderance of responsibility falls to the small business community.

The IRS recently changed Form 940 (Employers Federal Unemployment Tax Return) filings to quarterly from monthly. The problem is that small businesses may find uses for that money and inadvertently forget to file, report and pay timely. The IRS will generate late notices to the small business owner. These received notices require additional resources of time, effort and money, to reply to the notices. In many instances, penalties and statutory interest are added to the amount the small business may have to pay.

The Taxpayer Advocacy Panel issued its Annual Report, dated December 31, 2004. The report specifically mentions TAP involvement with the IRS and forms and publications. TAP made recommendations for improving the forms and procedures. A partial list includes the following:

- a) Offers in Compromise – Form 656 – clarifying comments and instructions
- b) Revisions to Form 6251 – Alternative Minimum Tax
- c) Form 2848 – Revision to the Power of Attorney
- d) W-4 – Employer/Employee Withholding
- e) Notice Standardization Guide
- f) Forms and Instructions Testing
- g) Form SS-4 – Employer Identification Number
- h) Language Standardization on Notices
- i) Form 1041 – Estates and Trusts
- j) EFTPS – Clarifying Instructions

It is evident from this list that the IRS needs assistance in helping to reduce burden. The IRS prints and distributes Publication 4109, Office of Taxpayer Burden Reduction. This publication specifically explains taxpayer burden and how the public can assist. The publication clearly states, “...IRS doesn’t have the ability to change existing tax laws; proposals involving legislative changes should be submitted to congressional representatives.”

Conclusion:

In 1980, the year the Paperwork Reduction Act was passed into law, the number of instruction booklet pages for the individual form 1040 was approximately 45 pages and the form itself

contained 68 lines. In 2004, the number of instruction booklet pages for the individual form 1040 was 128 pages and the form itself contained 75 lines. Burden has significantly increased in the last 25 years.

The issue of burden on small businesses falls squarely within the domain of the Congress. The IRS can only implement the will of the Congress. The Paperwork Reduction Act should be modified to ease the burden on small business tax compliance.

Recommendations:

- 1) Reduce tax law complexity. The continued complexity of the tax law and the forms continues to exact enormous burdens on small business and taxpayers.
- 2) Improve the documentation the IRS provides to small business. The forms should be written clearly and definitively. The forms should be easy to complete.
- 3) Do not close the Taxpayer Assistance Centers. These centers are very useful to small businesses. These centers allow small businesses to ask for assistance with completing forms, filing, reporting and paying taxes timely.
- 4) Require that the IRS demonstrate, with specific examples and by specific deadline dates, to this committee, that the IRS is complying with the letter and the spirit of the Paperwork Reduction Act.
- 5) Require that the IRS work with the Taxpayer Advocacy Panel to maintain a standing committee dedicated to reducing small business and taxpayer burden regarding all forms, publications and notices.

I sincerely thank you for the opportunity to address this Committee. Chairman Miller and members of the Committee, I look forward to our dialog and your questions on this issue.

Thank you.